Practice Tips for Tax Advisers

by Robert W. Wood

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In this article, Wood offers tax practice tips for advising on returns, evaluating tax positions, and making disclosures to the IRS and clients.

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Taxes are critical to nearly everything, affecting business and personal decisions everywhere. In that sense, you might think that tax advisers would be universally regarded as important all year. Perhaps they should be, and in some sectors they are. Yet, one might reasonably distinguish between different types of tax advisers. There are plenty of differences among us, but we all might be more similar than some would think.

There are tax lawyers advising on transactions and some of them might never see tax returns. There are tax litigators who defend solely what was done in the past. Yet, I would wager that even those individuals must field the occasional question about whether something is currently deductible.

There are tax preparers who work on taxes year-round and others whose work is seasonal. And there is much variation among those models. But for many people, tax return time is when any tax person matters the most. Tax lawyers who do not prepare tax returns should remember that great leveler.

The common tax return can affect just about all tax professionals in some surprising ways when it comes to liability and professional standards. Here are some practice tips for tax lawyers and other tax professionals. I am writing these from a lawyer's perspective, but some points could equally apply to accountants in our increasingly seamless tax profession.

Consider Yourself a Preparer

This one might sound silly. Some people know they are preparers 100 percent of the time, and some people think they never are. Many tax lawyers do not physically prepare tax returns, or they might prepare only some types of returns. Yet, even if you do not prepare returns yourself, you might be classified as a return preparer for some tasks.[1]

That can cause you to wonder whether you can parse your roles. You may not have preparer liability in every case, but you are probably better off *assuming* that you do. For example, you may be giving advice to clients about specific line items on their returns. Examples might include the deductibility of attorney fees or the tax treatment of a settlement payment. This is plainly advice *about* a return, regardless of whether the adviser signs it.

That makes the tax adviser a preparer. The the liability of signing return preparers and non-signing return preparers can be a nuanced topic.[2] However, to simplify these rules, it is safest to

[1] *See* section 7701(a)(36); reg. section 301.7701-15.

[2] *See* reg. section 1.6694-1(b)(2), (3).

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assume that you have preparer liability and to abide by the standards the IRS enunciates.

Consider Your Dual Role

A tax adviser has a unique role: helping clients comply with their tax obligations to the government. Of course, the adviser is also helping clients to comply in a way that is advantageous to *them*. Regardless of whether you view this role as quasi-governmental, the IRS and Treasury do. Detailed rules, including those in Circular 230,[3] explain what tax advisers and tax preparers can do.

There are do's and don'ts as well as penalties. Penalties can be imposed on the tax adviser apart from penalties on the taxpayer.[4] One set of potential penalties applies to tax return preparers, which turns out to be a term of art.[5]

Tax advisers should worry about giving good advice to please their clients and to keep them out of trouble. That involves the push-pull of not being too conservative and not being too much of a risk-taker. Some of this is about you, and some of it is about your client.

Not every client is the same or has the same perspective on risk and certainty. It is important to explore these issues. If something goes wrong, the client may seek legal recourse against the tax adviser. As with any other personal service business, consider malpractice liability. That militates in favor of good communication. A client who is taking risks should be well aware of them and their materiality.

Assess How Much Authority You Have

Carefully assess how much authority you have. Be thorough and circumspect. How do you determine whether your tax issue meets the "substantial authority" or "more likely than not" standard?

Consider the facts and the law. Evaluate the case law and administrative authority and use your best legal judgment on how these authorities would be applied to your facts.[6] Law school prepares you for this kind of evaluation but not necessarily for the types of percentage determinations that tax opinions require.

Speaking of percentages, you cannot consider audit rates. You must assume that the tax position will be audited and tested on the merits.[7] Some clients have a hard time with this. You don't have to invite an audit. In fact, there is nothing wrong with trying to make the return so pristine that it does not invite attention, assuming you are accurately reporting and fully disclosing when required.

But the confidence levels you express must *assume* an audit. There is substantial authority if the weight of the authorities supporting the tax treatment is substantial in relation to the weight of authorities supporting contrary treatment.[8] All authorities, pro and con, should be considered.[9] The weight of authorities is determined in light of the pertinent facts and circumstances.[10]

In determining whether there is substantial authority, you are not supposed to take into account the applicability of court cases to a taxpayer's situation because of the taxpayer's residence in a specific jurisdiction.[11] However, there *is* substantial authority for a position if there is controlling precedent from the U.S. Court of Appeals to which the taxpayer has a right of appeal regarding the position.[12] Thus, if there is a controlling favorable tax case in the Ninth Circuit, where the taxpayer lives, but unfavorable cases in all the other circuits, then there is substantial authority for the position.[13]

Regarding timing, you must be cognizant of changes in the law. There is substantial authority for a position only if there is substantial authority on the date the return or claim for refund is prepared, or if there was substantial authority on

[3] 31 C.F.R. part 10 (Circular 230).

[4] Circular 230 and sections 10.50(c) and 10.52(a).

[5] *See* section 6694(a).

[6] Circular 230 sections 10.32(a)(2), 10.34(a), and 10.37(a).

[7] *See* Circular 230 section 10.37(a).

[8] Reg. section 1.6662-4(d)(3)(i).

[9] *Id.*

[10] *Id.*

[11] Reg. section 1.6662-4(d)(3)(iv)(B).

[12] *Id.*

[13] *Id.*

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the last day of the tax year to which the return relates.[14]

Professional judgment is something that is difficult to discuss. Inevitably, some advisers may come to different conclusions than others. The standards are meant to be objective, but they are necessarily somewhat subjective, too. You may find disagreements, such as when one firm says it can issue only a substantial authority opinion while another may feel more confident in offering a more likely than not opinion.

You might even find an occasional "will" opinion that causes considerable head-scratching among other advisers. That can create palpable tension between your role in developing a client base and your duties under Circular 230.[15] Suppose that a prospective client has been told by three other law firms that only a "reasonable basis" opinion is possible. The prospect comes to you, and you can land a huge piece of business if you are willing to issue a more likely than not opinion.

The other firms could be wrong, of course, and you may have additional theories or additional arguments to support the proposed treatment. But while those opportunities might be very tempting, keep asking yourself if you are being objective. As tax-shelter-era experience has shown, sometimes people step over the line, or they might be drinking the promoter's Kool-Aid.

You should issue a more likely than not opinion only if you truly believe (based on your independent assessment of the law and the facts) that it is more likely than not that the position will prevail. If you are unsure whether you have enough favorable (and factually similar) authority to tip the balance in favor of your reported treatment (more likely than not means a *more* than 50 percent chance your position will prevail[16]), you should consider disclosing the position. It may help to debate the authorities with a colleague and to compare your assessments of the position's chances of success.

[14] Reg. section 1.6662-4(d)(3)(iv)(C).

[15] *See* Circular 230 section 10.34.

[16] Reg. section 1.6662-4(d)(2); *see* Circular 230 section 10.35(b)(4)(i).

When in Doubt, Disclose

It may sound trite, but one of best ways to avoid penalties as a preparer (and, therefore, also as an adviser who is *assuming* he is a preparer) is to ensure that the client discloses any tax position that is less than clear. Of course, it is tough to decide not only *whether* to disclose but also *how much* to disclose and on *which form* to do it. And you have your client to deal with, too.

In general, opt in favor of disclosure. Disclosure isn't a cure-all, but it is close to being one.[17] If you do not have the requisite level of authority to avoid preparer penalties *without* disclosure, you may avoid penalties by disclosure.

The disclosure should include a description of the relevant facts affecting the tax treatment of the item.[18] It must be sufficient to reasonably apprise the IRS of the reason for the disclosure.[19] Just as there can be differences of opinion about the chances of success of a particular tax position, there can be differences of opinion about what to say, and how to say it, in a disclosure.[20]

There are vast differences between disclosures that are minimalist (say, in the style of Hemingway) and those that are over-brimming (say, like Faulkner). Some disclosures in the return itself will be enough, and such white-paper disclosures can be a good idea.[21] Yet the IRS

[17] *See* Robert W. Wood and Milan N. Ball, "Tax Return Disclosures: What Is 'Adequate' and Why It Matters," *Tax Notes*, Jan. 2, 1017, p. 163.

[18] Section 6662(d)(2)(B)(ii)(I).

[19] *See, e.g.*, *Goeden v. Commissioner*, T.C. Memo. 1998-18 (taxpayer's disclosure, even though not "full and detailed," was considered adequate because the IRS was "alerted to the fact that petitioner had received settlement payments from the credit union, some taxable and some nontaxable"); *Elliott v. Commissioner*, T.C. Memo. 1997-294, *aff'd*, 149 F.3d 1187 (8th Cir. 1998) ("The test of adequate disclosure does not rest solely on whether a taxpayer has identified the correct section of the Code to support a reported deduction. What is critical is whether the taxpayer adequately disclosed enough relevant data concerning the treatment of the item to alert the Commissioner to a potential controversy.").

[20] *See* George R. Goodman, "Tax Return Compliance," *Tax Notes*, Sept. 1, 1997, p. 1201 (contending that usually taxpayers should make "the least disclosure necessary, though in some cases it might be possible to write a persuasive disclosure statement that has a strong chance of forestalling a challenge").

[21] For items for which disclosure on the return is sufficient, see Rev. Proc. 2016-13, 2016-4 IRB 290.

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prefers for disclosures to be made on Form 8275, which is specifically designed for this purpose.[22]

In the past, some courts approved white-paper disclosures in lieu of Form 8275.[23] However, the current regulations indicate that Form 8275 is necessary unless otherwise expressly permitted by revenue procedure.[24] Sometimes disclosure must be on Form 8275-R — for example, when you take a position that conflicts with a regulation.[25]

Disclosure is an important and underrated subject. No one wants to highlight his tax positions needlessly, especially tax positions that are aggressive. But disclosure is often necessary, and it should reduce rather than enhance the taxpayer's exposure. Evaluate when disclosure is needed, what form or format to use, and what one can expect if one does or does not disclose. Despite the importance of supplying adequate disclosures, some tax advisers may think of disclosure as an up or down decision. That can be a mistake.[26]

Inform Your Client

When you talk about disclosure, most tax professionals assume you are talking *solely* about disclosure *to the IRS*. But there is also disclosure to your client. Believe it or not, advisers sometimes overlook disclosing tax issues and risks to their clients.

It is simply good client relations to keep your client informed, so he knows the good, the bad, and the ugly. If treatment is uncertain, make sure he knows! Although this is good sense and common courtesy, you might be surprised to learn that the IRS also talks about disclosure to clients.

For example, you can avoid the section 6694 preparer penalty for tax shelter items if there is "substantial authority" for the position and if the preparer advises the taxpayer of the penalty standards applicable to the taxpayer if the transaction is deemed to have a significant purpose of federal tax avoidance or evasion.[27] This "tell your client" standard is detailed and unforgiving.

The advice to the taxpayer must explain that if the position has a significant purpose of tax avoidance or evasion, there must be: (1) at a minimum, substantial authority for the position; (2) a reasonable belief possessed by the taxpayer that the tax treatment was more likely than not the proper treatment in order to avoid a penalty under section 6662(d) as applicable; and (3) an understanding that disclosure in accordance with reg. section 1.6662-4(f) will not protect the taxpayer from assessment of an accuracy-related penalty if section 6662(d)(2)(C) applies to the position.[28] Also, a tax preparer should contemporaneously document this advice in her files.[29]

Beware Tax Shelters

Tax shelters are defined in section 6662(d)(2)(C)(ii) to include any plan or arrangement having a significant purpose of avoiding or evading federal income tax. Also, the reportable transactions to which section 6662A applies include listed and reportable transactions that have a significant purpose of tax avoidance or tax evasion.[30]

You can put to a side tax controversies in which you represent a client engaged in a dispute with the government. Apart from those controversies, there will be many transactions in which you are involved that may have tax ramifications as a significant purpose. "A significant purpose" need not be the principal purpose.

As a tax adviser, one of your primary jobs is trying to arrange your client's affairs to lawfully

[22] *See* reg. section 1.6662-4(f)(1). For more disclosure comments, see Wood and Ball, *supra* note 17.

[23] *See, e.g.*, *Corrigan v. Commissioner*, T.C. Memo. 2005-119 (applying former reg. section 1.6661-4(b)); *Goeden v. Commissioner*, T.C. Memo. 1998-18 (applying former section 6661); *see also Schirmer v. Commissioner*, 89 T.C. 277 (1987).

[24] *See* reg. section 1.6662-4(f)(2) ("If the revenue procedure does not include an item, disclosure is adequate with respect to that item only if made on a properly completed Form 8275 or 8275-R, as appropriate, attached to the return for the year or to a qualified amended return.") (applicable to returns due after December 31, 1991); Rev. Proc. 2016-13; *see also, e.g.*, *Campbell v. Commissioner*, 134 T.C. 20 (2010); *Zdun v. Commissioner*, T.C. Memo. 1998-296, *aff'd*, 229 F.3d 1161 (9th Cir. 2000).

[25] *See* reg. section 1.6662-4(f)(1).

[26] *See* Wood and Ball, *supra* note 17.

[27] Notice 2009-5, 2009 IRB 309.

[28] *Id.*

[29] *Id.*

[30] Section 6662A(b)(2).

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minimize taxes. But are tax ramifications the reason the client is entering into the transaction? Usually economic and business goals will be more important than tax goals, but the manner of accomplishing the business goals will be designed to be tax efficient. That does not mean the transaction *is* a tax shelter.

However, if the tax goals are paramount and the transaction is marketed for tax benefits, it seems fair to call it a tax shelter. The safest policy may be not to help create them, not to invest in them, not to advise clients to invest in them, and not to write tax shelter opinions. Yet those rules may be overcautious and may keep you from earning a living. In any case, preparing returns for clients who do (with proper disclosures) is OK, as is defending the client in a tax controversy.

Moreover, if you shun tax-shelter clients, you may prevent them from having good representation. Distinguish between the roles of designing shelters, opining on them, advising clients about them, preparing returns, and dealing with their aftermath. You may be willing to undertake some of those roles, but not others. However you come out on this personal debate, if you are going to venture into the shelter arena, it is best to know the ropes.

With tax shelters defined in section 6662(d)(2)(C)(ii), and with reportable transactions to which section 6662A applies, you incur a penalty under section 6694(a) unless you meet a high standard.[31] The penalty applies unless you had a reasonable belief that the position set forth in the return would more likely than not be sustained on the merits.[32] This applies for to returns prepared for tax years ending after October 3, 2008.[33]

Even if you try to avoid tax shelters, there may be circumstances in which you are uncertain if a transaction is a shelter. You must identify shelter transactions to that demand which the higher level of disclosure and scrutiny applies. The challenge is that the literal, statutory definition is broad enough to encompass many ordinary transactions.

[31] Section 6694(a)(1).

[32] Section 6694(a)(2)(C).

[33] *See* Notice 2009-5.

For example, what if your client is trying to solicit money via a stock offering with the promise of tax benefits? Say that your client makes the solicitation with the idea that some stock purchased before a specific date can give rise to tax-free gains when sold five years later. Does that make the transaction a tax shelter?

Presumably, it does not, because the primary *object* of the transaction was to raise capital for the business, not to generate tax benefits.[34] That is true even if the primary motivation for an individual investor might have been to obtain tax benefits.[35] There is simply nothing in the typical stock offering that seems to warrant the pejorative title of "tax shelter."

In most cases, a tax shelter will be readily recognizable. Keep an eye out for transactions that promise little economic gain other than tax benefits, that use financing techniques that don't conform to business practices, or that rely on strained (or incorrect) interpretations of the code, regulations, or rulings.[36] Watch for transactions in which seemingly disparate transactions and parts are cobbled together in a way that seems to make little economic sense. If the arrangement is a close call and you aren't comfortable that the transaction's tax treatment would satisfy the more likely than not standard, you should consider the consequences of its potential treatment as a tax shelter.

Keep Good Contemporaneous Records

Not only do you need to disclose to your client, you need to be able to prove that you did so.[37] That does not mean relying on your memory or your client's memory. Make a written record that you gave all required disclosures and did so in a timely manner. The preparer must

[34] *See Lore v. Commissioner*, T.C. Memo. 1990-56 ("The definition of a tax shelter thus directs our analysis to the purpose of the 'partnership, entity, plan, or arrangement,' rather than to the subjective motivation of the individual investors. Although the principal purpose of a plan may be difficult to discern, it is clear that when profit is not one of a plan's possible outcomes and the tax benefits sought are substantial, the plan's principal purpose is tax avoidance or evasion."); *accord Davis v. Commissioner*, T.C. Memo. 1989-607.

[35] *See Lore*, T.C. Memo. 1990-56.

[36] *See* reg. section 1.6662-4(g)(2)(i).

[37] Reg. section 1.6694-2(d)(3)(i)(C).

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contemporaneously document the advice in his files.

It is best to give advice in writing. Some advisers even ask the client to sign an acknowledgement that they received the disclosure, although this will annoy some clients.

If You Advise Another Preparer, Document It

One preparer may advise another. If a non-signing preparer provides advice to another preparer regarding a position for a tax shelter, the position will not be considered an unreasonable position if there is substantial authority for the position and if the non-signing preparer provides a statement to the other preparer about the penalty standards applicable to the preparer under section 6694.[38] Keep contemporaneous documentation in your files showing that you gave the statement to the other preparer.

Second-Guessing Clients and Advisers

Several tax advisers have gotten themselves into trouble by giving advice on suspect transactions. They may have thought they were protected by relying on factual assumptions and representations from their clients and other experts. Later, their advice was viewed as addressing hypothetical situations, not reality.

Some of us may remember seeing "profit motive" representations from clients from past tax-shelter eras. Such representations confirmed that the client was entering into a complex tax shelter because the client wanted to make an economic profit. They often were not credible. A tax practitioner must exercise due diligence in preparing all documents concerning IRS matters, including tax returns.[39] A preparer advising a client to take a position on a return cannot ignore the implications of information known to the preparer.

The preparer must make further inquiries if information furnished by the client appears to be incorrect, inconsistent, or incomplete.[40] In short, if you see something that seems odd or fishy, ask for more information. Don't give in to pressure to compromise your judgment if clarifying details aren't forthcoming.

It is difficult to do it, but there is a time to say that you can't continue with a representation, that you cannot issue an opinion of a specific standard, or that you can't participate unless the position is disclosed to your satisfaction.

Be Reasonable

This one is surprisingly important. Given perceived abuses by tax professionals in the past, the IRS now expects tax advisers to take a bigger role in policing the tax system. Dialogues with clients can be difficult.

For example, many taxpayers may be reluctant to attach Form 8275 to a return. They may feel that their position is strong, and that Form 8275 will flag their return for examination. Often, this fear is unjustified or at least overblown.

Because the basic form of disclosure is the Form 8275, there is reason to believe many of them are being filed. The vast majority, in my experience, do not prompt queries or audits. A white-paper disclosure can also be discussed and can be appropriate in some circumstances.

Whatever the vehicle for the disclosure, consider carefully the words and figures you used. Although taxpayers may shy *away* from disclosure, preparers may want to disclose almost *every* significant position they feel may be questioned. This can make clients angry, and there is at least the potential for a conflict of interest.

The preparer may recommend disclosure of an uncertain return position to avoid the accuracy-related penalty (on the taxpayer), the preparer penalty (on the preparer), or both. Preparers and their clients have to work through these issues. Usually it is not too difficult, but occasionally there will be hurt feelings or even terminations of engagements when clients and preparers disagree.

Although Circular 230 is complex and can be daunting, read it yourself. When appropriate, consult with colleagues. Sometimes it is invaluable to get some independent advice from others not as close to the situation or the client as you are.

[38] Reg. section 1.6694-2(d)(3)(ii)(A).

[39] Circular 230 section 10.22(a)(1).

[40] Circular 230 section 10.34(d).

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Conclusion

Tax advisers face enormous pressures. At times, it can be tempting to cut corners. If a matter justifies a full-blown tax opinion, there will hopefully be an adequate budget to consider these issues. You may be evaluating the matters discussed here as you go along. Formal tax advice is best considered from many angles.

If you are giving more ongoing and off-the-cuff tax advice, be especially careful. You may not be thinking about these issues, or not thinking about them thoroughly. It is not being paranoid to think about how a specific transaction or item would play out under examination. Consider what is in your files. Consider how it would look if the issue on which you are advising happens to go badly — with the IRS, your client, or both. ■

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